

**KENTUCKY LOCAL CORRECTIONAL  
FACILITIES CONSTRUCTION AUTHORITY  
FRANKFORT, KENTUCKY**

**FINANCIAL STATEMENTS AND  
INDEPENDENT AUDITOR'S REPORT**

June 30, 2005 and 2004

**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY  
FRANKFORT, KENTUCKY**

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## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors  
Kentucky Local Correctional  
Facilities Construction Authority  
Frankfort, Kentucky

We have audited the accompanying financial statements of the Kentucky Local Correctional Facilities Construction Authority (the Authority), a component unit of the Commonwealth of Kentucky, as of and for the years ended June 30, 2005 and 2004, as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Kentucky Local Correctional Facilities Construction Authority as of June 30, 2005 and 2004, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2 through 6 is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 15, 2005 on our consideration of the Kentucky Local Correctional Facilities Construction Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.



MOORE STEPHENS POTTER, LLP  
September 15, 2005

**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**

As management of the Kentucky Local Correctional Facilities Construction Authority (the Authority), a component unit of the Commonwealth of Kentucky, we offer the readers of the Authority's financial statements this narrative overview and analysis of the financial performance of the Authority for the fiscal years ended June 30, 2005 and 2004. We encourage readers to read it in conjunction with the Authority's financial statements and the accompanying notes.

**FINANCIAL HIGHLIGHTS**

- Cash, cash equivalents, and investments increased \$192,106 (3.0%)
- Lease agreement receivables (net of premium on leases) decreased \$3,453,349 (60.4%)
- Revenue bonds payable and other liabilities decreased \$6,638,438 (22.9%)
- The Authority's accumulated net deficit decreased \$3,166,096 (20.1%)
- Operating revenues decreased \$813,917 (14.0%)
- Operating expenses decreased \$1,264,074 (39.5%)
- Income from operations increased \$450,157 (17.3%)
- Income from investments increased \$102,379 (1780.5%)
- Two counties' lease agreement receivable balances were paid-off in-full (principal totaling \$3,092,566)
- The Authority issued \$21,670,000 in Multi-County Correctional Facilities Revenue Refunding Bonds, Series 2004, to redeem and discharge \$26,895,000 of the outstanding Series 1994 bonds (the refunding) (see page 6)

**OVERVIEW OF THE FINANCIAL STATEMENTS**

This financial report consists of three parts: Management's Discussion and Analysis (this section), the basic financial statements, and the accompanying notes to the financial statements. The Kentucky Local Correctional Facilities Construction Authority is a self-supporting entity and follows enterprise fund reporting; accordingly, the financial statements are presented using the economic resources measurement focus and the accrual basis of accounting. Enterprise fund statements offer short and long-term financial information about the activities and operations of the Authority. These statements are presented in a manner similar to those of a private business.

The statement of net assets presents information on all of the Authority's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Authority is improving or deteriorating.

The statement of revenues, expenses, and changes in net assets presents information showing how the Authority's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

The statement of cash flows provides relevant information about the cash receipts and cash payments of the Authority during the fiscal year. The statement should help users assess the Authority's ability to generate future net cash flows, meet future obligations as they become due, the Authority's need for future external financing, the reasons for differences in operating and related cash receipts and cash payments, and the effects on financial position of cash and non-cash investing, capital, non-capital, and financing activities.

**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)**

**OVERVIEW OF THE FINANCIAL STATEMENTS (CONTINUED)**

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to the financial statements can be found on pages 11-21.

**FINANCIAL ANALYSIS OF THE AUTHORITY**

**Condensed Financial Information (in thousands)**  
**Statement of Net Assets**  
**As of June 30**

	2005	Percentage Increase (Decrease)	2004	Percentage Increase (Decrease)	2003
Current assets	\$ 5,067	28.3%	\$ 3,949	28.5%	\$ 3,073
Non-current assets	4,697	-49.4%	9,287	-2.9%	9,569
Total assets	<u>9,764</u>	-26.2%	<u>13,236</u>	4.7%	<u>12,642</u>
Current liabilities	2,002	-12.6%	2,291	-0.5%	2,303
Non-current liabilities	20,313	-23.8%	26,662	-7.0%	28,670
Total liabilities	<u>22,315</u>	-22.9%	<u>28,953</u>	-6.5%	<u>30,973</u>
Accumulated net deficit	<u>\$ (12,551)</u>	-20.1%	<u>\$ (15,717)</u>	-14.3%	<u>\$ (18,331)</u>

**Current assets** consist primarily of the operating and program cash and cash equivalents and the current portion of lease agreement receivables.

**Non-current assets** consist primarily of debt service reserve cash and cash equivalents and investments and the non-current portion of lease agreement receivables.

**Current liabilities** consist primarily of the current portion of the revenue bonds payable due annually on November 1.

**Non-current liabilities** represent the non-current portion of the revenue bonds payable.

In providing funds for the construction and improvement of correctional facilities, the Authority obtains its funding through the issuance of revenue bonds and the receipt of court costs remittances. When revenue bonds are issued, the Authority incurs long-term obligations that are repaid primarily by revenue received from annual court costs receipts. When construction grants are awarded to local governments, the disbursements are immediately reflected as operating expenses. Due to the timing of these transactions, the Authority periodically incurs losses from operations. In addition, during 2003 House Bill No. 269 authorized the one-time non-reciprocal payment to the Commonwealth in the amount of \$15,000,000 (as discussed on page 5). As a result of these transactions, the Authority has accumulated a **net deficit**.

**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)**

**FINANCIAL ANALYSIS OF THE AUTHORITY (CONTINUED)**

**Condensed Financial Information (in thousands)**  
**Statement of Revenues, Expenses, and Changes in Net Assets**  
**For the Fiscal Year Ended June 30**

	<u>2005</u>	Percentage Increase (Decrease)	<u>2004</u>	Percentage Increase (Decrease)	<u>2003</u>
Operating revenues:					
Court costs receipts	\$ 4,602	-12.9%	\$ 5,281	8.9%	\$ 4,848
Interest income-leases	321	-26.0%	434	-5.7%	460
Other	74	-22.9%	96	0.0%	96
Total operating revenues	<u>4,997</u>	-14.0%	<u>5,811</u>	7.5%	<u>5,404</u>
Operating expenses:					
Construction grants	738	-51.5%	1,522	0.0%	1,522
Interest expense	1,134	-29.5%	1,608	-5.4%	1,700
Other	67	-8.2%	73	-7.6%	79
Total operating expenses	<u>1,939</u>	-39.5%	<u>3,203</u>	-3.0%	<u>3,301</u>
Income from operations	<u>3,058</u>	17.3%	<u>2,608</u>	24.0%	<u>2,103</u>
Non-operating revenues (expenses)	<u>108</u>	1700.0%	<u>6</u>	100.0%	<u>(14,943)</u>
Change in net assets	3,166	21.1%	2,614	120.4%	(12,840)
Accumulated net deficit, beginning of year	<u>(15,717)</u>	-14.3%	<u>(18,331)</u>	233.8%	<u>(5,491)</u>
Accumulated net deficit, end of year	<u>\$ (12,551)</u>	-20.1%	<u>\$ (15,717)</u>	-14.3%	<u>\$ (18,331)</u>

**Court costs receipts** represent 10.8% or \$10.80 of each \$100.00 court cost, up to \$5,400,000 each fiscal year, taxed against a defendant upon conviction in each case tried in a state Circuit or District Court. The court costs are collected by all circuit clerks in Kentucky and are submitted on a monthly basis. Any receipts collected above the \$5,400,000 each fiscal year are paid into the Commonwealth's General Fund.

**Interest income-leases** represents the portion of the rental payments received by the Authority under the leases from Local Governments in repayment of and as interest on a Local Government's agreed participation.

**Other operating revenues** consist of the amortization of the premium on leases.

**Construction grants** represent the annual installments of funding for construction and improvement of correctional facilities in ten counties throughout the state of Kentucky under two phases of grants. As of June 30, 2004, the Authority had no further obligations under the first phase of grants.

**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)**

**FINANCIAL ANALYSIS OF THE AUTHORITY (CONTINUED)**

**Interest expense** represents the interest due semi-annually each May 1 and November 1 on the revenue bonds payable. Also reflected within **interest expense** is the amortization expense relative to the bond premium/discount and the deferred amount on refunding.

**Other operating expenses** are primarily representative of the amounts due to the Office of Financial Management (OFM) to reimburse OFM for expenses incurred on behalf of the Authority and the amortization of the debt issuance costs.

**Non-operating revenues (expenses)** typically consist primarily of income from investments, which increased approximately \$102,000 (1780.5%) from 2004 due to the significant increase in the yields of the Authority's deposits. Income from investments for the year ended June 30, 2004 declined approximately \$79,000 (93.2%) from 2003. Income from investments for the year ended June 30, 2003 declined approximately \$224,000 (72.5%) from 2002.

During its 2003 Regular Session, the General Assembly of the Commonwealth of Kentucky passed House Bill No. 269 which contained a provision that, notwithstanding KRS 441.605 to 441.695 for fiscal year ended June 30, 2003, funds in the amount of \$15,000,000 shall be expended from the Kentucky Local Correctional Facilities Construction Authority for local correctional facility and operational support consistent with contractual covenants in accordance with bond indentures of the Authority. Accordingly, the 2003 financial statements include a non-reciprocal payment to the Commonwealth in the amount of \$15,000,000.

**Condensed Financial Information (in thousands)**

**Statement of Cash Flows**

**For the Fiscal Year Ended June 30**

	<u>2005</u>	Percentage Increase (Decrease)	<u>2004</u>	Percentage Increase (Decrease)	<u>2003</u>
Net cash provided by (used in):					
Operating activities	\$ 7,810	75.5%	\$ 4,449	6.5%	\$ 4,179
Non-capital financing activities	0	--	0	100.0%	(15,000)
Capital and related financing activities	(7,706)	117.6%	(3,541)	0.1%	(3,536)
Investing activities	<u>(2,247)</u>	-28187.5%	<u>8</u>	-99.4%	<u>1,293</u>
Net change in cash and cash equivalents	(2,143)	-334.0%	916	107.0%	(13,064)
Cash and cash equivalents, beginning of year	<u>6,474</u>	16.5%	<u>5,558</u>	-70.2%	<u>18,622</u>
Cash and cash equivalents, end of year	<u>\$ 4,331</u>	-33.1%	<u>\$ 6,474</u>	16.5%	<u>\$ 5,558</u>

**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)**

**FINANCIAL ANALYSIS OF THE AUTHORITY (CONTINUED)**

The **net change in cash and cash equivalents** totaled (\$2,143,073) at June 30, 2005 primarily due to the net cash used in investing activities attributable primarily to the \$2,335,179 purchase of debt service reserve investments during 2005. The **net change in cash and cash equivalents** totaled \$916,295 at June 30, 2004 primarily due to the \$449,381 increase in the cash received from court costs during 2004. The **net change in cash and cash equivalents** totaled (\$13,064,507) at June 30, 2003 primarily due to the \$15,000,000 payment to the Commonwealth and the \$1,292,900 net cash provided by investing activities attributable primarily to the \$1,190,000 in proceeds from the sale of investments during 2003.

**DEBT ADMINISTRATION**

On October 13, 2004, the Authority issued \$21,670,000 in Multi-County Correctional Facilities Revenue Refunding Bonds, Series 2004, to redeem and discharge \$26,895,000 of the outstanding Series 1994 bonds (see Note 2 to the financial statements). More detailed information about the Authority's debt is presented in Note 5 to the financial statements.

The following summarizes the changes (in thousands) in the Authority's debt resulting from the refunding during 2005 and the regularly scheduled principal and interest payments between fiscal years ended June 30, 2004 and 2003.

	<u>2005</u>	Percentage Increase (Decrease)	<u>2004</u>	Percentage Increase (Decrease)	<u>2003</u>
Revenue bonds payable	\$ 21,670	-25.1%	\$ 28,925	-6.3%	\$ 30,865
Unamortized premium	1,569	100.0%	0	--	0
Unamortized discount	0	100.0%	(233)	-8.6%	(255)
Unamortized deferred amount on refunding	<u>(1,081)</u>	-100.0%	<u>0</u>	--	<u>0</u>
Revenue bonds payable, net	<u>\$ 22,158</u>	-22.8%	<u>\$ 28,692</u>	-6.3%	<u>\$ 30,610</u>

**CONTACTING THE AUTHORITY'S FINANCIAL MANAGEMENT**

This financial report is designed to provide a general overview of the Authority's finances for all of those with an interest. If you have any questions concerning the information provided in this report or need additional financial information, contact the Office of Financial Management, Finance and Administration Cabinet, Commonwealth of Kentucky, Room 261, Capitol Annex, Frankfort, Kentucky, 40601.



**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**  
**STATEMENTS OF NET ASSETS**  
June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
<b><u>ASSETS</u></b>		
Current assets:		
Cash and cash equivalents	\$ 4,330,782	\$ 2,882,135
Court costs receivable	461,681	524,517
Accrued interest receivable-investments	21,042	705
Accrued interest receivable-leases	45,157	106,795
Lease agreement receivables	208,643	435,178
Total current assets	5,067,305	3,949,330
Non-current assets:		
Cash and cash equivalents-debt service reserve	32	3,591,752
Investments-debt service reserve	2,335,179	0
Lease agreement receivables	2,059,583	5,286,397
Debt issuance costs, net of accumulated amortization of \$21,556 in 2005 and \$408,744 in 2004	301,782	408,744
Total non-current assets	4,696,576	9,286,893
Total assets	9,763,881	13,236,223
<b><u>LIABILITIES</u></b>		
Current liabilities:		
Revenue bonds payable	1,845,000	2,030,000
Accounts payable	6,726	1,333
Accrued interest payable	149,900	259,693
Total current liabilities	2,001,626	2,291,026
Non-current liabilities:		
Revenue bonds payable	20,313,251	26,662,289
Total liabilities	22,314,877	28,953,315
<b><u>NET ASSETS</u></b>		
Accumulated net deficit	\$ (12,550,996)	\$ (15,717,092)

**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**  
**STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS**  
Years Ended June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Operating revenues:		
Court costs receipts	\$ 4,601,795	\$ 5,280,959
Interest income-leases	320,600	433,735
Amortization of premium on leases	74,393	96,011
Total operating revenues	<u>4,996,788</u>	<u>5,810,705</u>
Operating expenses:		
Construction grants	737,895	1,522,233
Interest expense	1,134,459	1,607,740
Amortization of debt issuance costs	34,741	39,556
Other operating expenses	31,726	33,366
Total operating expenses	<u>1,938,821</u>	<u>3,202,895</u>
Income from operations	<u>3,057,967</u>	<u>2,607,810</u>
Non-operating revenues:		
Income from investments	<u>108,129</u>	<u>5,750</u>
Change in net assets	3,166,096	2,613,560
Accumulated net deficit, beginning of year	<u>(15,717,092)</u>	<u>(18,330,652)</u>
Accumulated net deficit, end of year	<u>\$ (12,550,996)</u>	<u>\$ (15,717,092)</u>

**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**  
**STATEMENTS OF CASH FLOWS**  
Years Ended June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Cash received from court costs	\$ 4,664,631	\$ 5,242,279
Lease payments collected, including interest	3,909,981	849,251
Cash payments on construction grants	(737,895)	(1,522,233)
Cash payments for services	<u>(26,332)</u>	<u>(119,809)</u>
Net cash provided by operating activities	<u>7,810,385</u>	<u>4,449,488</u>
Cash flows from capital and related financing activities:		
Proceeds from the issuance of revenue bonds	23,351,789	0
Principal paid on revenue bonds	(2,030,000)	(1,940,000)
Redemption of revenue bonds	(27,432,900)	0
Interest paid on revenue bonds	(1,271,620)	(1,600,945)
Payments for debt issuance costs	<u>(323,338)</u>	<u>0</u>
Net cash used in capital and related financing activities	<u>(7,706,069)</u>	<u>(3,540,945)</u>
Cash flows from investing activities:		
Investment income received	87,790	7,752
Purchase of investments	<u>(2,335,179)</u>	<u>0</u>
Net cash provided by (used in) investing activities	<u>(2,247,389)</u>	<u>7,752</u>
Net change in cash and cash equivalents	(2,143,073)	916,295
Cash and cash equivalents, beginning of year	<u>6,473,887</u>	<u>5,557,592</u>
Cash and cash equivalents, end of year	<u>\$ 4,330,814</u>	<u>\$ 6,473,887</u>
Reconciliation of cash and cash equivalents to the statements of net assets:		
Current cash and cash equivalents	\$ 4,330,782	\$ 2,882,135
Non-current cash and cash equivalents-debt service reserve	<u>32</u>	<u>3,591,752</u>
Total cash and cash equivalents per the statements of net assets	<u>\$ 4,330,814</u>	<u>\$ 6,473,887</u>

**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**  
**STATEMENTS OF CASH FLOWS (CONTINUED)**  
Years Ended June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Reconciliation of income from operations to net cash flows from operating activities:		
Income from operations	\$ 3,057,967	\$ 2,607,810
Interest paid on revenue bonds	1,271,620	1,600,945
Amortization of premium on leases	(74,393)	(96,011)
Amortization of bond premium	(112,119)	0
Amortization of bond discount	7,507	22,520
Amortization of deferred amount on refunding	77,244	0
Amortization of debt issuance costs	34,741	39,556
(Increase) decrease in assets:		
Court costs receivable	62,836	(38,681)
Accrued interest receivable-leases	61,638	6,554
Lease agreement receivables	3,527,744	408,963
Increase (decrease) in liabilities:		
Accounts payable	5,393	(86,442)
Accrued interest payable	(109,793)	(15,726)
Net cash provided by operating activities	<u>\$ 7,810,385</u>	<u>\$ 4,449,488</u>

**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2005 and 2004

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

This summary of significant accounting policies of the Kentucky Local Correctional Facilities Construction Authority (the Authority) is presented to assist in understanding the Authority's financial statements. The financial statements and notes are representations of the Authority's management who is responsible for their integrity and objectivity. These accounting policies conform to generally accepted accounting principles and have been consistently applied in the preparation of the financial statements.

**Nature of Organization:**

The Kentucky Local Correctional Facilities Construction Authority is a public corporation and governmental agency of the Commonwealth of Kentucky created in 1982 by an Act of the Kentucky General Assembly. The purpose of the Authority is to provide up to 75 percent of the cost of construction, improvement, or repair of any jails operated by Kentucky local governments.

As a component unit of the Commonwealth of Kentucky, the accompanying financial statements are included in the Commonwealth's Comprehensive Annual Financial Report as a discretely presented component unit.

**Basis of Presentation:**

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The activities of the Authority are accounted for as an enterprise fund on the accrual basis of accounting. Accordingly, revenues are recognized when they are earned and expenses are recognized when they are incurred.

The Authority applies all Governmental Accounting Standards Board (GASB) pronouncements as well as the Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, in which case, GASB pronouncements prevail. The Authority has further elected not to apply FASB pronouncements issued after November 30, 1989, in accordance with GASB Statement No. 20.

As a result of adopting Governmental Accounting Standards Board Statement No. 34, "*Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*," in the year-ended June 30, 2002, the financial statements include a Management's Discussion and Analysis (MD&A) section providing an analysis of the Authority's overall financial position and results of operations.

**Use of Estimates:**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2005 and 2004

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Cash and Cash Equivalents:**

For purposes of the statements of cash flows, the Authority considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents.

**Net Assets:**

Net assets (when applicable) are displayed in three components:

- a. Invested in capital assets, net of related debt - Consists of capital assets including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- b. Restricted net assets - Consists of net assets with constraints placed on the use either by (1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments; or (2) law through constitutional provisions or enabling legislation.
- c. Unrestricted net assets - All other net assets that do not meet the definition of "invested in capital assets, net of related debt" or "restricted."

**Amortization of Premium on Lease Agreement Receivables:**

Premiums on lease agreement receivables are amortized on the straight-line method over the life of the related receivable. The results of this method do not materially differ from those that would be obtained by applying the effective interest method.

**Amortization of Bond Premium/Discount and Debt Issuance Costs:**

The bond premium (Series 2004 bonds)/discount (Series 1994 bonds) and the debt issuance costs are amortized on the straight-line method over the life of the bond issues. The results of this method do not materially differ from those that would be obtained by applying the effective interest method. The amortization of the bond premium/discount is charged to interest expense on the accompanying statements of revenues, expenses, and changes in net assets.

**Amortization of Deferred Amount on Refunding:**

The deferred amount on refunding is amortized on the straight-line method over the life of the Series 2004 bonds. The results of this method do not materially differ from those that would be obtained by applying the effective interest method. The amortization is charged to interest expense on the accompanying statements of revenues, expenses, and changes in net assets.

**Operating Revenues and Expenses:**

Operating revenues and expenses for enterprise funds are those that result from providing services. It also includes all revenues and expenses not related to capital and related financing, non-capital financing, or investing activities.

**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2005 and 2004

**NOTE 2 - CURRENT REFUNDING**

On October 13, 2004, the Authority issued \$21,670,000 in Multi-County Correctional Facilities Revenue Refunding Bonds, Series 2004, with an original issue premium of \$1,681,789 and interest rates ranging between 2.25% and 5.25% (see Note 5). The Series 2004 bonds were issued by the Authority to redeem and discharge \$26,895,000 of the outstanding Series 1994 bonds with interest rates on the serial and term bonds ranging between and 5.05% and 5.50% (the refunding). The serial and term bonds maturing on or after November 1, 2005 were subject to redemption prior to their stated maturity at the option of the Authority on any interest payment date on or after November 1, 2004, at a redemption price of 102% of the principal amount redeemed. Accordingly, the Authority redeemed \$27,432,900 as a result of this current refunding.

The current refunding reduced total debt service payments over the next 10 years by approximately \$3,600,000. This results in an economic gain (difference between the present values of the debt service payments on the Series 1994 and 2004 debt) of approximately \$2,300,000.

Additionally, as a result of this refunding the Authority has recognized a deferred amount on the refunding in the amount of \$1,158,663 (see Note 5). This amount represents the difference between the reacquisition price relative to the Series 1994 bonds outstanding (including the 102% call premium) and the net carrying amount of the Series 1994 bonds (including the unamortized discount and debt issuance costs). The unamortized deferred amount on the refunding is reported in the accompanying statement of net assets as a deduction from the outstanding revenue bonds payable as of June 30, 2005 (see Note 5).

**NOTE 3 - CASH, CASH EQUIVALENTS, AND INVESTMENTS**

Pursuant to the issue of the Multi-County Correctional Facilities Revenue Refunding Bonds, Series 2004 (see Note 5), the Authority entered into a Trust Indenture Agreement with U.S. Bank National Association of Louisville, Kentucky as Trustee. The Trust Indenture provides for the issuance of the bonds and the establishment of the following special accounts with the Trustee.

**Construction Account:**

Funded from the bond proceeds of any Series required to be deposited therein, available funds of the Authority, or other sources as determined by Series resolution, to be applied to the acquisition, construction, reconstruction, and equipping of the projects designated and the necessary expenses incidental thereto. No disbursements shall be made from the Construction Account unless the Trustee receives a written Requisition for Funds approved by the Authority.

**Costs of Issuance Account:**

Established from bond proceeds for the purpose of paying the costs of issuing such bonds.

**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2005 and 2004

NOTE 3 - CASH, CASH EQUIVALENTS, AND INVESTMENTS (CONTINUED)

Debt Service Fund:

Interest Account:

To receive transfers from the Revenue Fund for payments of the interest becoming due on the bonds on said interest payment dates.

Principal Account:

To receive transfers from the Revenue Fund for payments of the principal becoming due on the bonds on said principal payment dates.

Debt Service Reserve Fund:

There shall be paid into the Debt Service Reserve Fund any proceeds of bonds or a surety bond (or other credit facility) so provided to be deposited therein by any Series resolution, as well as the pledged receipts from the Revenue Fund, an amount equal to the payment of the principal installments of, or interest on, any outstanding bonds (the "aggregate debt service reserve requirement"), but only to the extent amounts in the Debt Service Fund and the Revenue Fund are not adequate for such purpose. The "aggregate debt service reserve requirement" shall mean an amount equal to the lesser of (a) 10% of the stated aggregate principal amount of the bonds, (b) the maximum annual debt service requirement in the current year or any succeeding bond fiscal year with respect to all outstanding bonds, and (c) 125% of the average annual debt service requirement with respect to all outstanding bonds.

Payment, Surplus, and Operating Fund:

There shall be paid into the Payment, Surplus, and Operating Fund the amounts required to be so paid by the provisions of the Trust Indenture, including amounts transferred from the Revenue Fund. Notwithstanding anything in the Trust Indenture to the contrary, moneys in the Payment, Surplus, and Operating Fund may be withdrawn and paid out by the Trustee to or at the direction of the Authority for any lawful purpose of the Authority, including, but not limited to, paying reasonable or necessary operating costs and making grants to Local Governments. When amounts permitted are so withdrawn and paid out, such moneys shall be free and clear of any lien, pledge, or assignment in trust created by this Trust Indenture.

Revenue Fund:

All of the pledged receipts of the Authority, including court costs, investments earnings, rental payments and supplemental rental payments, shall be deposited in the Revenue Fund and disbursed for payment of interest and principal which will come due on the bonds on said interest and principal payment dates.



**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2005 and 2004

NOTE 3 - CASH, CASH EQUIVALENTS, AND INVESTMENTS (CONTINUED)

At June 30, 2005 and 2004 the components of the revenue bond accounts are as follows:

	<u>2005</u>	<u>2004</u>
Costs of issuance account	\$ 8,204	\$ 0
Debt service reserve fund	2,335,211	3,591,752
Operating account	0	5,336
Payment, surplus, and operating fund	49,752	43,813
Revenue fund	<u>4,272,826</u>	<u>2,832,986</u>
Total cash, cash equivalents, and investments	6,665,993	6,473,887
Less non-current debt service reserve cash and cash equivalents	(32)	(3,591,752)
Less non-current debt service reserve investments	<u>(2,335,179)</u>	<u>0</u>
Total current cash and cash equivalents	\$ <u>4,330,782</u>	\$ <u>2,882,135</u>

As of June 30, 2005, the Authority's investments are as follows:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Maturity</u>
U.S. Treasury Department Treasury Bonds, State and Local Government Series	\$ <u>2,335,179</u>	October 31, 2014

As of June 30, 2005, the Authority's remaining funds on deposit with the Trustee (cash and cash equivalents) are invested in the First American Government Obligation Fund. As of June 30, 2004, all of the Authority's funds on deposit with the Trustee are cash and cash equivalents invested in the U.S. Treasury Reserve Fund. As of June 30, 2005 and 2004, all cash and cash equivalent funds are uninsured and uncollateralized.

*Custodial Credit Risk:* For an investment, custodial credit risk is the risk that in the event of the failure of the counterparty, the Authority will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Authority has no formal policy on custodial credit risk. As of June 30, 2005, the Authority's investments are neither insured nor registered, but are held by the Authority's counterparty in the Authority's name.

*Credit Risk:* The Trustee, on behalf of The Authority, is permitted to invest Authority funds in the following:

- o obligations backed by the full faith and credit of the United States
- o obligations of any corporation of the United States Government
- o collateralized or uncollateralized certificates of deposit issued by banks or other interest-bearing accounts in depository institutions chartered by Kentucky or by the United States
- o bankers acceptances
- o commercial paper
- o securities issued by a State or local government, or any instrumentality or agency thereof in the United States

**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2005 and 2004

**NOTE 3 - CASH, CASH EQUIVALENTS, AND INVESTMENTS (CONTINUED)**

- Unites States denominated corporate, Yankee, and Eurodollar securities, excluding corporate stocks, issued by foreign and domestic issuers
- asset-backed securities
- shares of mutual funds, not to exceed 10% of the total funds available for investment
- State and local delinquent property tax claims

*Concentration of Credit Risk:* The Authority places no limit on the amount the Authority may invest in any one issuer, with the exception of investments in mutual funds as indicated above.

*Interest Rate Risk:* The Authority does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates relative to its investment in U.S. Treasury Department Treasury Bonds, State and Local Government Series.

**NOTE 4 - LEASE AGREEMENT RECEIVABLES**

Lease agreement receivables represent the participating counties' agreed amount of bond principal required to finance the counties' share of project costs funded through the bond issue. As of June 30, 2005 and 2004, no allowance for uncollectible balances is considered necessary. The counties and their respective amounts are as follows:

	<u>2005</u>	<u>2004</u>
Adair	\$ 243,950	\$ 291,224
Estill	103,462	125,510
Franklin	1,018,821	1,216,192
Fulton	180,600	215,521
Johnson	0	652,694
Kenton	0	2,656,341
Knox	276,310	329,839
McCreary	163,265	194,556
Montgomery	482,001	573,376
Powell	135,203	161,121
Simpson	<u>203,157</u>	<u>242,407</u>
	2,806,769	6,658,781
Less premium on leases	<u>(538,543)</u>	<u>(937,206)</u>
Net lease agreement receivables	2,268,226	5,721,575
Less current maturities	<u>(208,643)</u>	<u>(435,178)</u>
Non-current lease agreement receivables	\$ <u>2,059,583</u>	\$ <u>5,286,397</u>

Premium on leases represents the difference between the amount of bond principal assigned and bond proceeds allocated to the participating counties, which reflects the counties' share of bond issuance costs. As a result of the refunding during 2005, the counties' collective share of bond issuance costs decreased in the total amount of \$398,663.

**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2005 and 2004

**NOTE 4 - LEASE AGREEMENT RECEIVABLES (CONTINUED)**

Future minimum lease payments required under the lease agreement receivables at June 30, 2005 are as follows:

Year Ending June 30

2006	\$	208,643
2007		222,061
2008		236,348
2009		251,553
2010		267,734
Thereafter		<u>1,620,430</u>
	\$	<u>2,806,769</u>

**NOTE 5 - REVENUE BONDS PAYABLE**

On October 13, 2004, the Authority issued \$21,670,000 in Multi-County Correctional Facilities Revenue Refunding Bonds, Series 2004, to redeem and discharge \$26,895,000 of the outstanding Series 1994 bonds (see Note 2).

Activity within revenue bonds payable during the year ended June 30, 2005 is as follows:

Multi-County Correctional Facilities Revenue Refunding Bonds, Series 1994:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Serial bonds	\$ 11,235,000	\$ 0	\$ 11,235,000	\$ 0
Term bonds	<u>17,690,000</u>	<u>0</u>	<u>17,690,000</u>	<u>0</u>
	28,925,000	0	28,925,000	0
Unamortized discount	<u>(232,711)</u>	<u>225,204</u>	<u>(7,507)</u>	<u>0</u>
Totals - Series 1994	\$ <u>28,692,289</u>	\$ <u>225,204</u>	\$ <u>28,917,493</u>	\$ <u>0</u>

Multi-County Correctional Facilities Revenue Refunding Bonds, Series 2004:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Amounts Due Within One Year</u>
Serial bonds (a)	\$ 0	\$ 21,670,000	\$ 0	\$ 21,670,000	\$ 1,845,000
Unamortized premium	0	1,681,789	112,119	1,569,670	0
Unamortized deferred amount on refunding	<u>0</u>	<u>(1,158,663)</u>	<u>(77,244)</u>	<u>(1,081,419)</u>	<u>0</u>
Totals - Series 2004	<u>0</u>	<u>22,193,126</u>	<u>34,875</u>	<u>22,158,251</u>	\$ <u>1,845,000</u>
Totals	\$ <u>28,692,289</u>	\$ <u>22,418,330</u>	\$ <u>28,952,368</u>	\$ <u>22,158,251</u>	

**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2005 and 2004

**NOTE 5 - REVENUE BONDS PAYABLE (CONTINUED)**

- (a) Serial bonds at interest rates ranging from 2.25% to 5.25%, principal due annually on November 1 in amounts ranging from \$1,845,000 to \$2,530,000 through November 1, 2014, interest due semiannually each May 1 and November 1

Activity within revenue bonds payable (Multi-County Correctional Facilities Revenue Refunding Bonds, Series 1994) during the year ended June 30, 2004 is as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Amounts Due Within One Year</u>
Serial bonds	\$ 13,175,000	\$ 0	\$ 1,940,000	\$ 11,235,000	\$ 2,030,000
Term bonds	<u>17,690,000</u>	<u>0</u>	<u>0</u>	<u>17,690,000</u>	<u>0</u>
	30,865,000	0	1,940,000	28,925,000	2,030,000
Unamortized discount	<u>(255,231)</u>	<u>0</u>	<u>(22,520)</u>	<u>(232,711)</u>	<u>0</u>
	<u>\$ 30,609,769</u>	<u>\$ 0</u>	<u>\$ 1,917,480</u>	<u>\$ 28,692,289</u>	<u>\$ 2,030,000</u>

The Series 2004 bonds are not subject to redemption prior to maturity. The Series 2004 bonds are, however, subject to special redemption, without premium, to the extent of casualty insurance proceeds, condemnation awards, and monies received from a Local Government electing to purchase its project. The Series 2004 bonds are also subject to extraordinary redemption, without premium, due to the failure by a Local Government to initiate construction of its project within the time permitted under the lease and participation agreement.

Bonds to be redeemed due to a special or extraordinary redemption shall be bonds which mature, or are subject to mandatory sinking fund redemption, on the principal installment dates that correspond to the dates the principal portion of the rental payments under the related lease and participation agreement were due.

The scheduled payments of principal and interest, when due, are guaranteed under a financial guaranty insurance policy issued by MBIA Insurance Corporation. All cash, cash equivalents, and investments of the Authority held by the Trustee bank are pledged as collateral for the bond indebtedness.

**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**  
**NOTES TO THE FINANCIAL STATEMENTS**  
 June 30, 2005 and 2004

**NOTE 5 - REVENUE BONDS PAYABLE (CONTINUED)**

The bonds are special and limited obligations of the Authority and, except to the extent payable from the proceeds of such bonds or other monies pledged under the Trust Indenture, are payable from the pledged receipts as described below, to the extent such sources exist.

1. The Authority is entitled to 10.8% or \$10.80 of each \$100.00 court cost, up to \$5,400,000 each fiscal year, taxed against a defendant upon conviction in each case tried in a State Circuit or District Court. The court costs are collected by all circuit clerks in Kentucky and are submitted on a monthly basis. Any receipts collected above the \$5,400,000 each fiscal year are paid into the Commonwealth's General Fund.
2. Rental payments received by the Authority under the leases from Local Governments in repayment of and as interest on a Local Government's agreed participation.
3. All interest earned and gains realized on investment obligations acquired with monies on deposit under the Trust Indenture other than the Payment, Surplus, and Operating Fund.
4. Any gifts or grants received from any agency of government, both Federal and State, to the extent not otherwise required to be applied.
5. Any and all appropriations made to the Authority by the General Assembly of the Commonwealth of Kentucky to the extent not otherwise committed during any fiscal period of the Authority.

Debt service requirements at June 30, 2005 are as follows:

<u>Year Ending June 30</u>	<u>Principal</u>	<u>Interest</u>
2006	\$ 1,845,000	\$ 871,725
2007	1,940,000	814,950
2008	1,995,000	763,406
2009	2,040,000	710,363
2010	2,105,000	648,188
2011-2015	<u>11,745,000</u>	<u>1,575,131</u>
	<b>\$ <u>21,670,000</u></b>	<b>\$ <u>5,383,763</u></b>

**NOTE 6 - CONSTRUCTION GRANTS**

On September 9, 1994, the Authority adopted a resolution for the funding of regional jails in the counties of Bourbon, Boyd, Hardin, Marshall, and Rockcastle. These awards are to be paid in ten equal annual installments beginning in October 1994. The Authority's total participation in these projects (Phase 1 Grants) is \$7,843,379. As of June 30, 2004, the Authority had no further obligations under the Phase 1 Grants.

**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**  
**NOTES TO THE FINANCIAL STATEMENTS**  
 June 30, 2005 and 2004

**NOTE 6 - CONSTRUCTION GRANTS (CONTINUED)**

On June 10, 1997, the Authority adopted a resolution for the funding of regional jails in the counties of Ballard, Boyle, Calloway, Henderson and Letcher. These awards are to be paid in ten equal annual installments beginning in October 1997. The Authority's total participation in these additional projects (Phase 2 Grants) is \$7,378,954.

Disbursements on these projects through June 30, 2005 and the remaining obligations are as follows:

	<u>Grant Amount</u>	<u>Cumulative Disbursed by Year Ended June 30, 2003</u>	<u>Disbursed Year Ended June 30, 2004</u>	<u>Disbursed Year Ended June 30, 2005</u>	<u>Obligation Remaining at June 30, 2005</u>
<u>Phase 1 Grants</u>					
Bourbon	\$ 1,150,000	\$ 1,035,000	\$ 115,000	\$ 0	\$ 0
Boyd	700,000	630,000	70,000	0	0
Hardin	4,259,185	3,833,266	425,919	0	0
Marshall	1,612,194	1,450,975	161,219	0	0
Rockcastle	122,000	109,800	12,200	0	0
<u>Phase 2 Grants</u>					
Ballard	183,442	110,064	18,344	18,344	36,690
Boyle	2,146,589	1,287,954	214,659	214,659	429,317
Calloway	1,530,650	918,390	153,065	153,065	306,130
Henderson	2,974,273	1,784,562	297,427	297,427	594,857
Letcher	544,000	326,400	54,400	54,400	108,800
	<u>\$ 15,222,333</u>	<u>\$ 11,486,411</u>	<u>\$ 1,522,233</u>	<u>\$ 737,895</u>	<u>\$ 1,475,794</u>

**NOTE 7 - ACCUMULATED NET DEFICIT**

In providing funds for the construction and improvement of correctional facilities, the Authority obtains its funding through the issuance of revenue bonds and the receipt of court costs remittances. When revenue bonds are issued, the Authority incurs long-term obligations that are repaid primarily by revenue received from annual court costs receipts. When construction grants are awarded to local governments the disbursements are immediately reflected as operating expenses. Due to the timing of these transactions, the Authority periodically incurs losses from operations. In addition, during 2003 House Bill No. 269 authorized the one-time non-reciprocal payment to the Commonwealth in the amount of \$15,000,000. As a result of these transactions, the Authority has accumulated a net deficit as of June 30, 2005 in the amount of \$12,550,996.

**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2005 and 2004

**NOTE 8 - RELATED PARTY TRANSACTIONS**

The Authority receives the benefit of accounting and administrative services from the Office of Financial Management (OFM). OFM serves as staff to the Authority and is reimbursed for the costs of salaries, fringe benefits, personnel costs, etc. in the amount of \$25,000 per year. During 2005 and 2004, the Authority reimbursed OFM \$25,000 for these costs.

Additionally, the accompanying statement of net assets as of June 30, 2005 reflects accounts payable totaling \$6,726. These funds are to reimburse OFM for professional services it had paid on behalf of the Authority. During 2004, the Authority reimbursed OFM \$7,034 for the professional services it had paid on behalf of the Authority during the year.

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON  
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS  
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Board of Directors  
Kentucky Local Correctional  
Facilities Construction Authority  
Frankfort, Kentucky

We have audited the financial statements of the Kentucky Local Correctional Facilities Construction Authority as of and for the year ended June 30, 2005, and have issued our report thereon dated September 15, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Kentucky Local Correctional Facilities Construction Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Kentucky Local Correctional Facilities Construction Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, the Board of Directors, and the Auditor of Public Accounts of the Commonwealth of Kentucky, and is not intended to be and should not be used by anyone other than these specified parties.

*Moore Stephens Potter, LLP*

MOORE STEPHENS POTTER, LLP  
September 15, 2005



**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**  
**SCHEDULE OF FINDINGS**  
Year Ended June 30, 2005

Schedule of auditor's results

We have issued an unqualified opinion dated September 15, 2005 on the financial statements of the Kentucky Local Correctional Facilities Construction Authority as of and for the year ended June 30, 2005.

Our audit disclosed no instances of noncompliance which are material to the Authority's financial statements.

Findings relating to the financial statements

Our audit disclosed no findings that are required to be reported in accordance with *Government Auditing Standards*.

**KENTUCKY LOCAL CORRECTIONAL FACILITIES CONSTRUCTION AUTHORITY**  
**SCHEDULE OF PRIOR AUDIT FINDINGS AND THEIR RESOLUTION**  
Year Ended June 30, 2005

The audit as of and for the year ended June 30, 2004 disclosed no findings that were required to be reported in accordance with *Government Auditing Standards*.